No. 90-972

In the Supreme Court of the United States

OCTOBER TERM, 1990

BRUCE M. JONES, ET AL., PETITIONERS

v.

EDWARD J. DERWINSKI,
SECRETARY OF VETERANS AFFAIRS, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

The Department of Veterans Affairs guarantees home loans made to veterans by private lenders. The question presented is whether regulations that create a federal right to indemnity against a veteran who has defaulted on his mortgage preempt a conflicting California law that prohibits such indemnification.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Statutes and regulations:

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OPINIONS BELOW

The decision of the court of appeals (Pet. App. A1-A7) is unreported. The decision of the district court (Pet. App. B1-B28) is reported at 699 F. Supp. 795.

JURISDICTION

The judgment of the court of appeals was entered on September 24, 1990. The petition for a writ of certiorari was filed on December 17, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Department of Veterans Affairs provides housing assistance to qualified veterans by guaranteeing home

loans made to the veterans by private lenders.[1] See 38 U.S.C. 1801-1833. When a veteran obtains a VA-guaranteed loan, he must sign "indemnity agreements," see Pet. App. B5-B6, that set out the terms of the guaranty. *Ibid.* These agreements state that they are governed by federal law and that the veteran will be liable for all amounts paid by the VA in the event of default. *Id.* at B6. The implementing regulations likewise provide that federal law "shall govern the rights, duties, and liabilities of the parties," 38 C.F.R. 36.4334, and establish that any amounts paid to the lender by the VA "constitute a debt owing to the United States by [that] veteran," 38 C.F.R. 36.4323(e).

If the veteran defaults on a VA-guaranteed loan, the lender may foreclose on the property pursuant to the law of the state where the property is located. See 38 U.S.C. 1820(a)(6). If a deficiency on the mortgage debt remains after foreclosure and sale of the property, the VA must reimburse the lender up to the amount of its guaranty. See 38 C.F.R. 36.4321; Pet. App. B7. The regulations provide two means by which the VA may recover from the veteran the amount paid on the guaranty: first, the VA is subrogated to the rights of the lender and can pursue any cause of action the lender would have against the veteran, 38 C.F.R. 36.4323(a); second, since the amount the VA paid on the veteran's behalf constitutes a debt to the United States, the VA may seek direct indemnification from the veteran, 38 C.F.R. 36.4323(e); see 1 V.A. Dec. 1154 (1945).

2. Petitioners, two veterans and the wife of one of the veterans, Pet. App. B1-B2,[2] obtained VA-guaranteed home

[1] The Department of Veterans Affairs was formerly the Veterans Administration, see Pet. App. B1, and for ease of reference we refer to it as "the VA."

[2] Petitioners sought to represent the class of similarly situated California veterans and spouses, but the district court did not reach the issue of class certification. See Pet. App. B3.

loans on which they defaulted. *Id.* at B2. The lenders foreclosed and sold the properties, and the resulting deficiencies were paid by the VA pursuant to its guaranty. *Ibid.* Petitioners brought this action in United States District Court for the Northern District of California seeking an injunction against VA indemnity proceedings against them. *Id.* at B2-B3. Petitioners contended that the VA could not proceed against them by virtue of California's Anti-Deficiency Law, Cal. Civ. Proc. Code § 580b (West 1976), which bars the holder of a loan secured by real property from collecting deficiencies remaining after foreclosure and sale of the property, and also prohibits the guarantor of such loans from seeking indemnity against his principal. See Pet. App. B8-B10; *Commonwealth Mortgage Assurance Co.* v. *Superior Court*, 211 Cal. App. 3d 508, 259 Cal. Rptr. 425 (1989).

The district court granted summary judgment for the VA. Pet. App. B27-B28. Relying on *United States* v. *Shimer*, 367 U.S. 374 (1961), and *McKnight* v. *United States*, 259 F.2d 540 (9th Cir. 1958), the court determined that the VA's independent right to indemnity under 38 C.F.R. 36.4323(c) allowed it to recover from petitioners, "notwithstanding state statutes which might preclude such recovery by a guarantor other than the VA." Pet. App. B17. The district court held that although the California anti-deficiency law might limit the VA's right to subrogation, that law directly conflicted with the VA's independent right to indemnity and was therefore "nullified." *Id.* at B19.[3]

[3] The district court held alternatively that "federal common law creates a nationwide federal rule permitting the VA to seek indemnity." Pet. App. B20. Applying the test of *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 728-729 (1979), the court concluded that the nationwide guaranty program was best served by a uniform rule of law, that adoption of state law would frustrate the integrity of the program, and that the exercise of the VA's independent right of indemnification would not disrupt commercial expectations. Pet. App. B20-B26.

3. The court of appeals affirmed. The court held that it had already "considered this precise issue" in *United States v. Rossi*, 342 F.2d 505 (9th Cir. 1965), where it held that the VA's right to indemnity conflicted with, and therefore displaced, this very state law. Pet. App. A4-A5. *Rossi*, the court stated, "is still the law in this circuit," and under that decision "federal law preempts state law." *Id.* at A6-A7.[3]

ARGUMENT

The court of appeals, following earlier decisions involving the same regulations at issue here, simply reaffirmed that a long-standing federal regulation whose validity this Court has upheld may not be thwarted by conflicting state law. That decision is correct and does not conflict with any decision of this Court or of any other court of appeals. No further review is warranted.

1. Petitioners principally contend (Pet. 11-16) that the courts below erroneously relied on *Shimer* to find that the VA's regulations preempted California's anti-deficiency statute.

The facts of *Shimer* are quite similar to those here. The VA brought indemnification proceedings against a defaulted veteran on whose behalf the VA had repaid a lender under the same guaranty program at issue in this case. *Shimer*, 367 U.S. at 375-376. This Court rejected the veteran's assertion that the Pennsylvania Deficiency Judgment Act pro-

[3] The court of appeals noted its recent reaffirmance of *Rossi* in *Whitehead v. Derwinski*, 904 F.2d 1362 (9th Cir. 1990), where the court confronted another state's antideficiency law. There, however, the court of appeals held that the state law was not preempted because it allowed the VA to exercise its right to subrogation through a judicial foreclosure, and therefore the state law did not invariably conflict with federal regulations, unlike the California law at issue here. *Whitehead* distinguished the present case on that ground, and the court of appeals in this case likewise distinguished *Whitehead*. See Pet. App. A5-A6.

hibited the VA from proceeding against him. Instead, the Court determined that the state procedures for calculating a deficiency were displaced by federal procedures for doing so. *Id.* at 377-381.

Most importantly for present purposes, the Court rejected the veteran's argument that the VA had no right to indemnity independent of its right to subrogation. Instead, the Court held that "the statute affords an independent right of indemnity to the Veterans' Administration." *Shimer*, 367 U.S. at 387. That was so because "waiver of a guarantor's normal rights * * * would deprive the guarantor of any recovery on occasions when the mortgagee's rights were limited as against the debtor by state law, yet were protected against the [VA] by state or federal law. Relief from liability in these circumstances would convert a guaranty into a grant of aid," in contravention of "the entire history" of the program. *Id.* at 386-387.[5]

Conversion of their guaranties into grants of aid is precisely what petitioners seek here. As they concede (Pet. 8), "California law * * * absolutely prohibit[s] the VA from collecting * * * from petitioners." Yet, since the lender's rights are protected against the VA by federal regulations—the VA must pay the guaranty—allowing petitioners to escape liability to the VA would turn what Congress designed as a guaranty program into a grant program. This situation is exactly the one *Shimer* sought to avoid by affirming the VA's independent federal right to indemnification from the veteran. The district court and the court of appeals therefore correctly relied on *Shimer* for the disposition of this case.

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[5] *Shimer* noted with approval the Ninth Circuit's decision in *McKnight* v. *United States*, 259 F.2d 540 (1958). See *Shimer*, 367 U.S. at 387.

Congress recently restructured the VA Home Loan program. See Veterans' Benefits Amendments of 1989, Pub. L. No. 101-237, Tit. III, §§ 301-313, 103 Stat. 2069-2078 (to be codified at 38 U.S.C. 1803). The statutory changes eliminate the independent federal right to indemnity (as well as the right to subrogation) for VA-guaranteed loans closed after January 1, 1990, but preserve both rights for loans closed before that date.[6] The issue presented here is therefore one of diminishing importance not appropriate for review by this Court.

2. California law directly conflicts with the federal scheme and is irreconcilable with it: the state bans indemnity completely, and the federal rule creates a right to indemnity. See, *e.g.*, *City of New York* v. *FCC*, 486 U.S. 57 (1988). Thus, basic preemption principles provide for the primacy of the federal regulation. Although Congress has "not completely displaced" state regulation in this area (as evidenced by its general incorporation of state foreclosure proceedings), "state law is nullified to the extent that it actually conflicts with federal law." *Fidelity Fed. Sav. & Loan Ass'n* v. *De la Cuesta*, 458 U.S. 141, 153 (1982), as it does here. As described above, "state law 'stands as an obstacle to the accomplishment and execution of the full purposes

[6] By doing so, Congress implicitly ratified both *Shimer* and the VA's longstanding practice. Although Congress was made aware of pending lawsuits, including this one, challenging the VA's right to indemnification, and was urged to eliminate that right and the right to subrogation, see *Hearing Before the Subcomm. on Housing and Memorial Affairs of the House Comm. on Veterans' Affairs*, 101st Cong., 1st Sess. 76-77 & n.1 (1989) (prepared statement of Mr. David Leen), it instead left indemnification and subrogation intact for loans closed before 1990). As this Court has stated, "[w]here an agency's statutory construction has been fully brought to the attention of * * * Congress, and [it] has not sought to alter [the] interpretation although it has amended the statute in other respects, then presumably the legislative intent has been correctly discerned." *North Haven Bd. of Educ.* v. *Bell*, 456 U.S. 512, 535 (1982) (citations omitted).

and objectives of Congress.'" *Ibid.*, quoting *Hines* v. *Davidowitz*, 312 U.S. 52, 676 (1941); see *Hillsborough County* v. *Automated Medical Laboratories*, 471 U.S. 707, 712-713 (1985). Therefore, as both courts below correctly held,[7] the VA has an independent federal right to indemnification from petitioners that California may not block.[8]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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[7] Their holdings were not novel, for *United States* v. *Rossi*, *supra*, and *McKnight* v. *United States*, *supra*, reached identical conclusions.

[8] Petitioners' remaining argument is without merit. *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979), and the other cases they rely upon address the question of what law governs federal programs when there is no specified federal rule, and are therefore irrelevant where, as here, there is a direct conflict between federal regulations and state law.